This record is a partial extract of the original cable. The full text of the original cable is not available.

C O N F I D E N T I A L SECTION 01 OF 03 RANGOON 001387

SIPDIS

STATE FOR EAP/MLS; PACOM FOR FPA; TREASURY FOR OASIA:AJEWELL

E.O. 12958: DECL: 12/04/2015
TAGS: ECON EFIN PGOV BM
SUBJECT: BURMA'S PRIVATE BANKS WAITING IN THE WINGS

Classified By: Econoff TLManlowe for Reasons 1.4 (b,d)

¶1. (SBU) Summary: Burma's six private banks, while offering an alternative to its highly inefficient state financial institutions, continue to suffer from the country's 2003 banking crisis. Operating under onerous restrictions, arbitrary interventions and a bleak investment climate results in slim profit margins. The private sector, however, is where much of the country's economic sense resides. Economic sense, however, does not enter into the regime's policy making. Thus, the banking system declines along with the economy as a whole. End summary.

¶2. (C) Without an independent Central Bank, regime leaders with little or no economic background have run the banking system in Burma into the ground over the last forty years. From the late General Ne Win, who said the kyat (Burma's currency, currently trading at 1150/$1 on the black market), would devalue "over my dead body," to former PM Khin Nyunt, who told an economist from the Central Bank, "you don't even have to give the briefing, I know when the proper time to devalue the kyat will be," to former Finance Minister Khin Maung Thein, who arrested moneychangers to stop an informal kyat depreciation, Burmese leaders have repeatedly ignored good advice from their economists. In some unusually frank meetings, a former Deputy Governor of the Central Bank and other members of the small private banking community told econoff how uninformed economic decisions have ruined the economy and caused difficulties for private banks.

Crash Survivors Tightly Controlled

¶3. (C) Three large state banks, nine quasi-government institutions, and six totally private banks make up Burma's banking sector. The biggest state bank, Myanmar Economic Bank, has 400 billion kyat ($348 million at the market rate) in deposits. The largest quasi-government bank, Myawaddi (owned by active and retired military members of Myanmar Economic Holdings Limited), holds about 81 Billion kyat in deposits (approximately $70.5 million). The second largest quasi-government bank, Inwa Bank, is owned by the Ministry of Defense. In comparison, the largest fully private bank holds about 67 billion kyat (about $58 million) in deposits. Total banking system deposits in 2004 were 736.4 billion kyat ($826 million at average 2004 market exchange rates), according to IMF estimates. Of Burma's eighteen banks, only the six private banks must comply with the severe restrictions that the GOB imposed after its banking crisis in 2003. Most significantly, private banks can only accept deposits not exceeding seven times the amount of paid-in capital. This greatly restricts their capacity to loan, invest, or expand. The state also dictates maximum interest rates, which, since the year 2000, have been stuck at 10% for deposits (also the Central Bank discount rate) and 15% for loans. Based on embassy surveys, we estimate annual inflation at 25-30%.

¶4. (C) According to IMF estimates, in 2004, overall banking system lending reached 2.250 trillion kyat ($2.52 billion at the average 2004 informal exchange rate), with less than 20% of loans going to the private sector. State banks support the public sector, while most private bank loans go to the private sector, according to bank sources. The "private sector", however, includes crony businessmen like Te Za, the son-in-law of Senior General Than Shwe. Te Za has borrowed extensively from both state (Myanmar Economic Bank) and private banks, according to sources in those banks. Since the 2003 crisis, the more fiscally conservative private banks hold relatively small portfolios of non-performing loans. Some private banks, however, are not so prudent or cannot manage to evade financing demands from regime leaders, but they can avoid Central Bank scrutiny. For example, Yoma Bank (a private bank) has never technically received a permit to operate after the 2003 crisis. Yet it continues to offer services, and accepts deposits, even, according to one banker, well above the state-imposed 7:1 ratio. "The owner must know someone," he concluded.

¶5. (U) Private banks offer clients an alternative to highly inefficient state banks, which discourage most large depositors through slow, unfriendly service and closer scrutiny of transactions. Private banks cannot deal in foreign currency, but can offer personal or commercial loans, trade facilities and consumer banking services. No banks offer credit cards or ATMs, mainly because of difficulties

caused by international sanctions on financial transactions. Private banks primarily provide trade facilitation, domestic remittance services and working capital loans. Given limits on business they can accept, private banks develop relationships with a small number of reliable clients. As confidence in the client grows, the banks extend more credit on longer terms to the same clients, rather than seek new customers. Since the private banks have reached their deposit limits, many Burmese now build safes in their houses to store large amounts of cash, the bankers said.

Hard Currency is Hard to Capture

¶6. (U) Only two state banks can deal in foreign currencies. Remittances from overseas workers and payments from foreign importers are taxed at 10%. Payments from overseas for tourism services are taxed at 7%. To avoid this tax, workers and others sending hard currency into the country use the "hundi" system of informal remittances. Also, much undeclared cash is hand-carried across the borders. These practices keep most of the privately-earned hard currency out of the banking system entirely. Also, foreign banks can only open representative offices to provide information and assistance. Branch offices are prohibited.

Burmese "Bankers' Hours"

¶7. (C) In sessions they jokingly referred to as "Morning School," the managers of the biggest private banks must go every workday morning to the Finance Minister's office to brief him on current conditions, providing information used in the Minister's briefing for Senior General Than Shwe. Every night, these same bankers go to "Night School," which sometimes lasts until midnight, where they report their day's activities to the Central Bank. The Central Bankers manually transcribe the day's banking activities from the private banks' computer printouts.

¶8. (SBU) The GOB is clearly printing more money, as there has been an influx of new 1000 kyat notes in circulation recently (in a new smaller size similar to the US dollar). Since no kyat have been withdrawn from the economy, the new money adds to inflation pressure. The market value of the kyat depreciated 30% from November 2004 to November 2005, according to Embassy surveys of moneylenders. Despite the tight government restrictions and rising inflation, bank contacts manage to operate with a slim profit margin from lending and relending on short terms the same restricted pool of money, and from fees on remittance and trade facilitation services. Banks also earn 8.5% interest on treasury bonds they buy from the Central Bank. They do not fear competition because the sector does not attract new investors. The near term outlook for the economy remains negative, they say, with fewer customers requesting loans for start-ups or expansions.

Comment: Saving For the Future

¶9. (SBU) Although the majority of bank assets still lie firmly in the hands of the regime, private banks play a vital role in supporting private sector activity. They cannot realize their potential to finance growth of a strong private sector because restrictions keep their client base small. Entrepreneurs, businesspeople without an existing strong banking relationship, and new entrants into the business world have nowhere to go for fast, reliable service. They are faced with surly state banks or informal support from friends and relatives. Prevented from expanding to meet demand, some bankers appeared to want to get out of the business, but are reluctant to lose their existing investment. The bankers we spoke to recognize the economic damage done by regime policies. Unfortunately the regime, unwilling to hear bad news, has driven sound economic and financial advisors away. Thus the private banks have gotten caught up in the downward spiral of the economy, and nation, in general. End comment.
VILLAROSA